INCREASING PRESSURE ON THE MIDDLE CLASS

An Update 2000-2006

by Elizabeth Warren
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Never before have middle class families worked so hard just to break even. The typical two-parent family now has both mom and dad in the workforce, even if the children are small.[3] Increasing numbers of one-parent families are juggling both work and home life with no back-up help. Even households without children are struggling to pay the bills and try to put something aside.

In our earlier work, *The Two-Income Trap*, we compared the family of a generation ago with the family of the early 2000s. A generation ago, the typical family had only one income, but they could afford to buy a home,[4] put aside more than 11% of their paycheck in savings,[5] and still take a two-week vacation. By contrast, today's median family has both parents in the workforce,[6] and yet they are struggling to buy a

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[1] Leo Gottlieb Professor of Law, Harvard Law School, and co-author of *The Two Income Trap*. This report was prepared with the very capable research assistance of Mona Lewandoski Harvard Law School Class of 2008.
[2] COO, Business Talent Group, and co-author of *The Two-Income Trap*.
[3] U.S. Census Bureau, 2005 *American Community Survey* S2302 (2005), *available at* http://factfinder.census.gov/servlet/STTable?_bm=y&-qr_name=ACS_2005_EST_G00_S2302&-geo_id=01000US&-ds_name=ACS_2005_EST_G00_&-format=&-CONTEXT=st (62.7% of married couples with minor children have both parents in the paid workforce).
[4] In the early 1970s, the median first-time home buyer put down nearly 20% of the purchase price of a new home, financing only about 80%. Most (70.9%) reported that their down payments came entirely from savings, and 20.4 percent said they also had help from relatives. U.S. Bureau of the Census, Data User Services Division, *Statistical Abstract of the United States 1982–83*, 103rd ed. National Data Book and Guide to Sources, compiled by Glenn W. King under the direction of Paul T. Zeisset (Washington, DC, 1982), p. 762, Table 1367, Recent Home Buyers—General Characteristics and Downpayments, 1976 to 1981.
[5] Bureau of Economic Analysis, Table 2.1 Personal Income and Its Disposition, available at www.beagov/bea/dn/nipaweb/TableView.asp?SelectedTable=58&FirstYear=2004&LastYear=2006&Freq=Qtr.
[6] U.S. Census Bureau, supra note 3.

home[7] and keep health insurance. Their savings rate has dropped below zero,[8] and they are carrying record-breaking debt loads.[9]

In this brief report we revisit the economic data to review the recent progress—or lack of progress—of the average, middle class American family. Are things getting better? Is the turnaround in sight? Or are families in the middle squeezed even tighter? The basic data—income and expenses—paint a picture of families who are struggling harder than ever just to break even.

Income, 2000-2006

The fully employed male remains the benchmark—the most consistent way to measure over time how workers are faring in America. Annual earnings for those men with full-time employment offer a critical picture both of the economy and of the economic health of typical American families.

The news, even for those lucky enough to have avoided layoffs and cutbacks, is not encouraging. Even in nominal dollars (not adjusted for inflation), these fully-employed workers are making only slightly more than they did five years ago.[10] Five years of wage increases added up to only $3,297—or about $275 a month. That is a cumulative increase of about 8.5%, or about 1.7% per year. It is important to note that, when adjusted for inflation, wages have actually declined.[11] But to make apples-to-apples comparisons here on incomes and major expenses, we use current dollars, setting aside the very real impact of inflation on a number of items from food to dental care that are not listed here.

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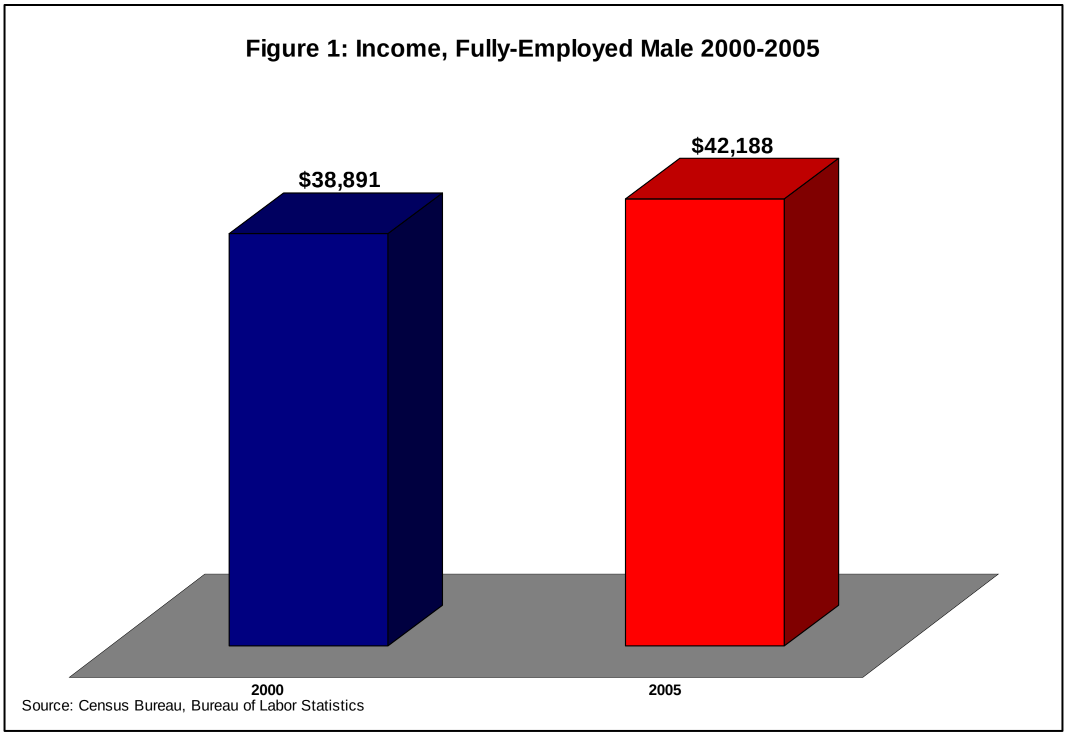
[7] The proportion of middle-income families who would be considered "house poor" has doubled since 1975. U.S. Census Bureau, *Annual Housing Survey for the United States and Regions, 1975, Part C, Financial Characteristics of the Housing Inventory,* Annual Survey (1977), Table A-1, Income of Families and Primary Individuals in Owner and Renter Occupied Housing Units, 1975. Available at http://www.census.gov/prod/www/abs/h150.html [3/10/2003]; *American Housing Survey for the United States: 2001*, Annual Survey (2001), Table 2-20, Income of Families and Primary Individuals by Selected Characteristics—Occupied Units, available at http://www.census.gov/hhes/www/housing/ahs/ahs01/ tab313.html.

[8] Bureau of Economic Analysis, *Personal Income and Its Disposition*, Table 2.1, available at www.beagov/bea/dn/nipaweb/TableView.asp?SelectedTable=58&FirstYear=2004&LastYear=2006&Freq=Qtr.

[9] Federal Reserve, *Statistical Release G-9, Consumer Debt*, available at www.federalreserve.gov/releases/g19/hist/cc_hist_sa.html.

[10] Bureau of Labor Statistics, *Average Hourly Earnings of Production of Nonsupervisory Workers on Private Nonfarm Payrolls by Industry Sector and Selected Industry Detail, Seasonally Adjusted*. Available at www.bls.gov.

[11] According to the latest Census survey, real median household income declined $1,273 from $47,599 in 2000 to $46,326 in 2005. U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2005* at 31, available at www.census.gov/prod/2006pubs/p60-231.pdf.



To get a sense of how the typical family is doing,[12] we take that additional $275 a month that the average full-time worker is making to see how it stacks up against increases in a few basic expenses.

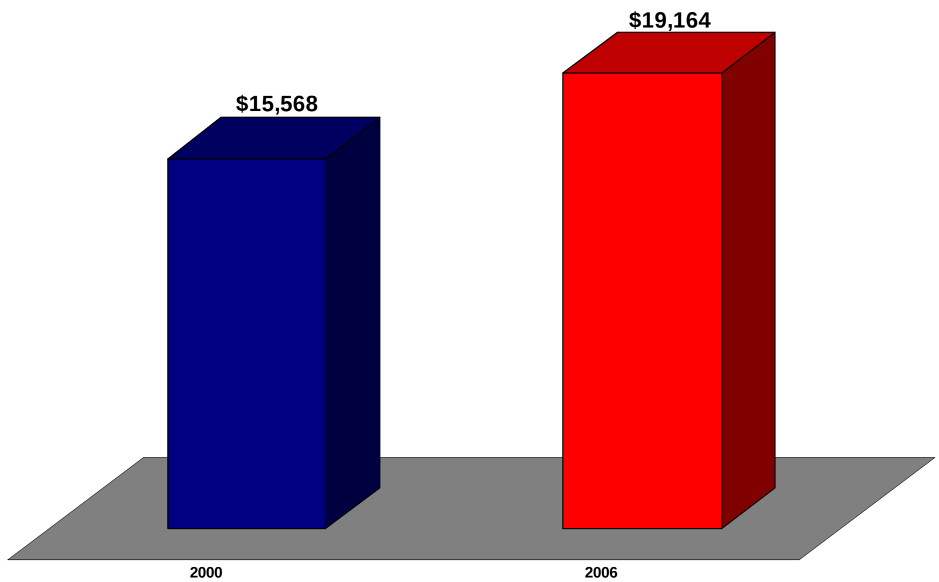
Expenses, 2000-2006

Housing

The single biggest expense for Americans remains the family home. But the cost of owing and maintaining a home over the past five years has increased by 23%. This means that the family in 2006 is spending, on average, $300 more a month just to cover the same basic housing expenses they covered in 2000.

[12] Some analysts cite to increases (in some years) in household or family incomes. But that tells about the family's response to economic pressure—sending mom back to work or taking a second job—not about the basic jobs-and-the-economy equation. The economy has not improved for workers if more people have to go to work in order for the household to break even. To cope with rising costs, the two-parent family can send both parents to work. In fact, nearly two-thirds of all families with minor children and two parents have done just that. But that strategy won't help the family that has only one parent. And it won't help the family that has ALREADY sent them to work. (Who goes to work next? The children?). Similarly, people could take a second job or a third job or they could sell a kidney. There are lots of ways to survive financially. The point of this analysis is that for the hours-worked, the family is falling further and further behind.

Figure 2: Homeownership Costs, 2000-2006



Source: Bureau of Labor Statistics, Consumer Expenditure Survey, Customized Tables, Series CXUPH 000405

If families were getting a lot more house for their dollars, then this picture would not be so worrisome. Despite McMansions springing up in the suburbs and growth in the size of new housing, the typical family is not buying that five-bedroom manse with the media room and spa shower. Instead, middle class families are much more likely to be living in older housing,[13] and their homes have remained significantly under 2000 square feet.[14]

The housing cost data are particularly worrisome because of the substantial number of families who are currently within the "teaser rate" period on home mortgages that were taken out or refinanced within the past two years. In 2007, about 11% of all outstanding mortgage debt will reset, and millions of homeowners will see their mortgage payments increase substantially.[15]

The pressure on homeowners is intensifying rapidly. These upward rate adjustments will add to the alarming increase in foreclosures. According to RealtyTrac, the month of August saw a 24 percent increase in foreclosures from July, and an increase of nearly 53 percent from August 2005.[16]

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[13] The proportion of owner-occupied houses twenty-five years or older grew from 40 percent in 1975 to 59 percent in 1999. U.S Census Bureau, *American Housing Survey, 1999,* Current Housing Reports, H150/99 (October 2000), Table 3-1, Introductory Characteristics—Owner Occupied Units; *American Housing Survey: 1975, General Housing Characteristics,* Current Housing Reports, H-150-75A (April 1977), Table A1, Characteristics of the Housing Inventory, 1975 and 1970.

[14] U.S. Census Bureau, *American Housing Survey, 2005*.

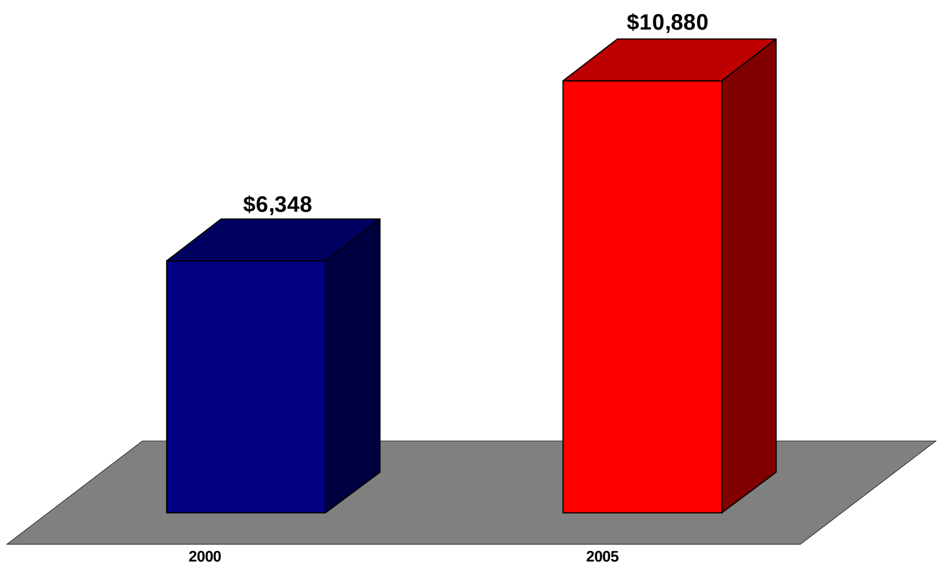
[15] LoanPerformance, *reported in Mortgage Moms' May Star in Midterm Vote, Washington Post* (Sept. 5, 2006).

[16] RealtyTrac, *U.S. Foreclosure Market Report* (Sept. 13, 2006).

Health Insurance

From 2000 to 2005, the cost of health insurance has increased by a staggering 71%. Health insurance for the typical family in America costs about $378 a month more than the same health insurance coverage in 2000.[17]

Figure 3: Family Health Insurance Premiums, 2000-2005



Source: Kaiser Family Foundation, 2006

For many families, the rising cost of health insurance has simply priced them out of the market. From 2000 to 2005, the number of Americans not covered by health insurance increased by 6.8 million.[18]

Gasoline

From January 2001 to August 2006 the cost of gasoline has more than doubled, from $1.45 to $2.95 for regular grade gas.[19] While usage varies around the country (as does price), with more families sending both mom and dad into the workforce and more

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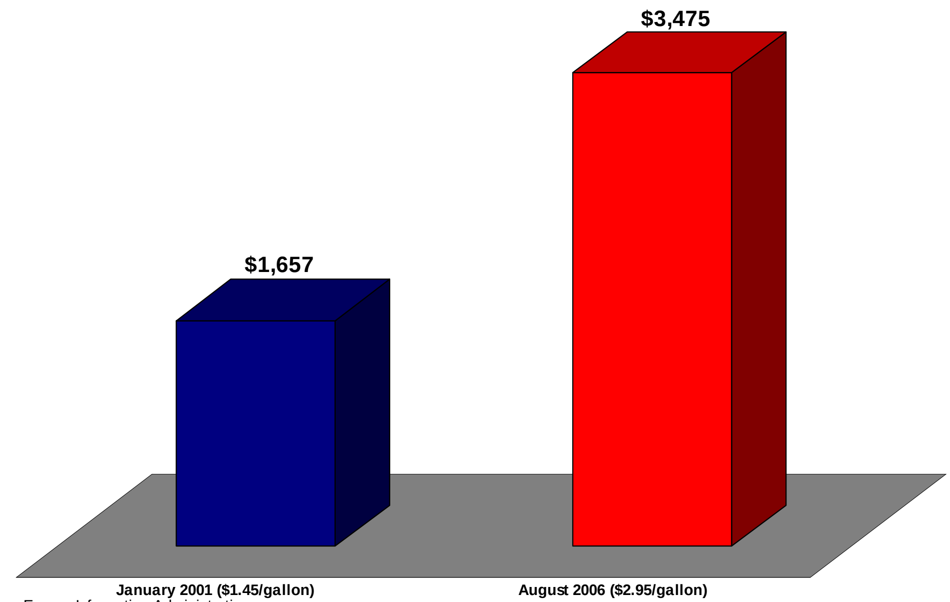
[17] Kaiser Family Foundation and Health Research Educational Trust, EMPLOYER HEALTH BENEFITS 2000 ANNUAL SURVEY 2 (2005); Kaiser Family Foundation and Health Research Educational Trust, EMPLOYER HEALTH BENEFITS 2000 ANNUAL SURVEY 13 (2000).

[18] U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2005* 60, available at www.census.gov/prod/2006pubs/p60-231.pdf.

[19] Department of Energy, *Retail Gasoline Historical Prices*, available at www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_history.html. Full month September figures are not yet available.

families searching for housing in distant suburbs, families got hit with both higher consumption and higher prices. The difference in cost from 2001 to August 2006 in the monthly gasoline charges was about $152.

Figure 4: Gasoline Costs, 2001-2006



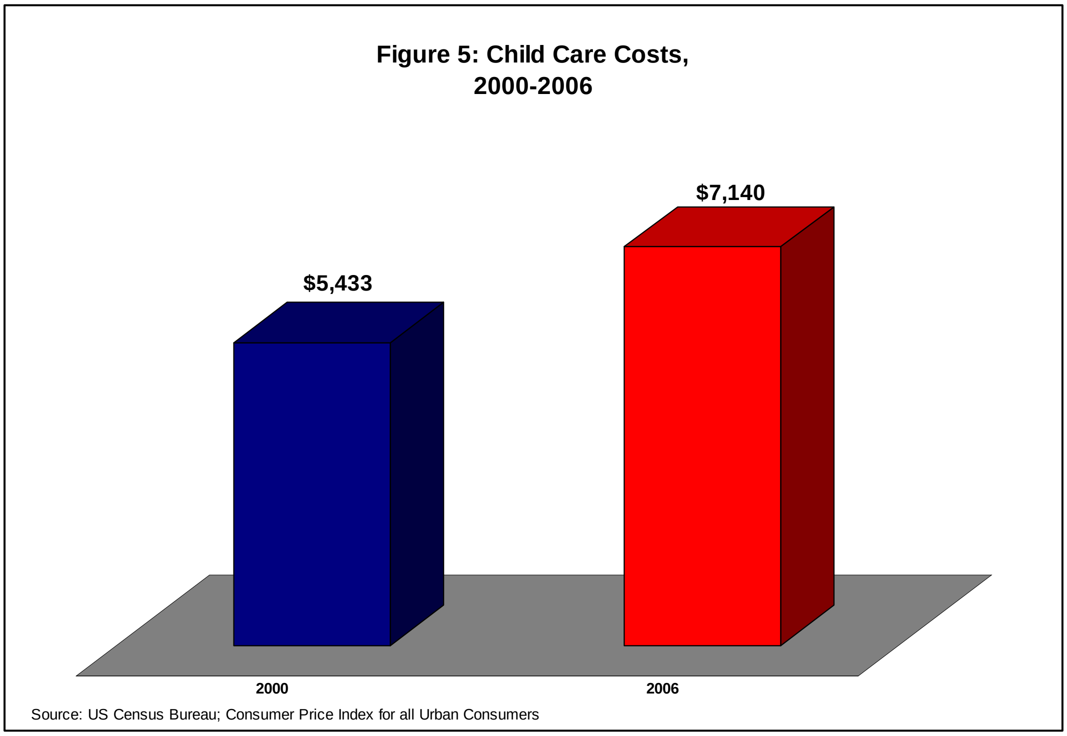
Source: Energy Information Administration

The increase in gas prices hits some families especially hard. Those two-income families who have two long commutes to work pay a lot. Families that moved to the suburbs, families living in rural areas, and families that live in cities without adequate public transportation feel an even bigger difference in gas prices.

Child Care or College

Ask any middle class parent: children are expensive. A home in a good school district (see above), health insurance (see above), back-to-school sneakers and trips to the dentist put a strain on every family's budget. But two specific costs are emblematic of the challenges facing middle class parents—childcare and college. These are the costs that nearly every parent encounters today. They are not the only costs, but they are among the largest and most constant costs that mark trying to keep a child safe and to prepare that child for her own place in the middle class.

The costs of child care cut sharply into a working parent's budget. In 2000, families with full-time working mothers spent an average of $5433 when they put a pre-school aged child in daycare. By 2006, that same care cost $7140.[20]



For each child under the age of six, the increase is another $142 more each month that a parent must spend for care.

The costs of college have jumped even more sharply. For a child in a four-year public university, the costs of room, board, tuition and fees have increased 44% over the 2000 to 2006 time period.[21]

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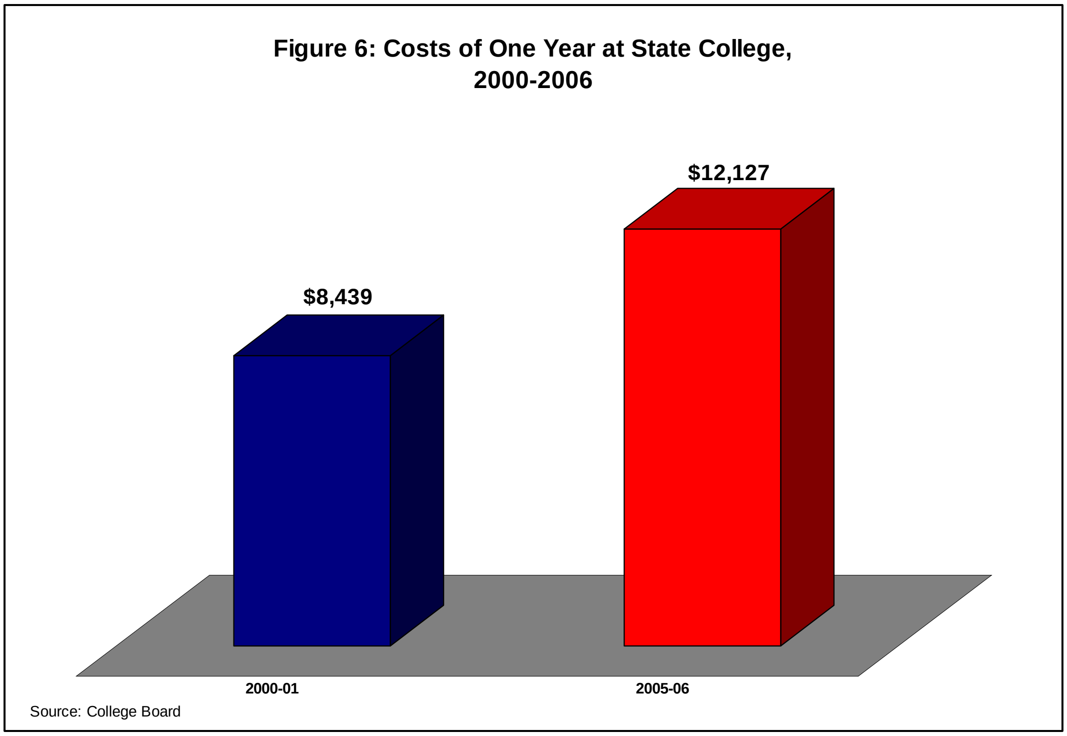
[20] Figure derived from calculations based on US Census Bureau, *Who's Minding the Kid? Child Care Arrangements: Spring 99* Table 6, p. 5; Bureau of Labor Statistics, *Consumer Price Index for All Urban Consumers: US City Average by expenditure category and commodity and service group, for 1999, 2000, 2005, and July 2006*, available at www.bls.gov (base weekly cost of $99 translates into annual cost of $5148, inflated for 2000 and 2006 (seasonally adjusted) numbers).

[21] College Board, TRENDS IN COLLEGE PRICING 11 (2005), available at wwwcollegeboard.com/prod_downloads/press/cost05/trends_college_pricing_05.pdf#search=%22is%20report%2C%20based%20on%20the%20College%20Board%E2%80%99s%20Annual%20Survey%20of%20Colleges%2C%22.



For anyone trying to send a youngster to college, the costs are now equivalent to 29% of annual income for a fully-employed male. The family in 2006 has a bill that is $307 larger every month than a similar family back in 2000.

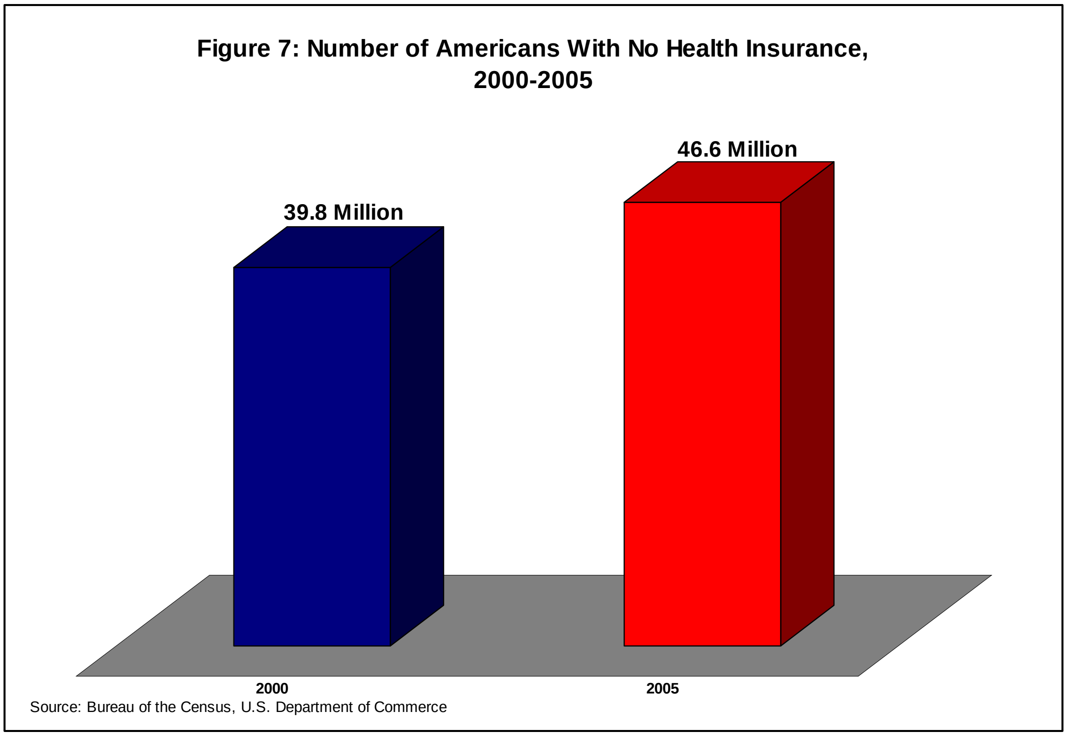
For a growing number of families each year, the only answer is debt—and more debt.[22] That extra college expense of $307 each month is loaded onto the amount borrowed. It will accumulate interest and eventually come out of future family budgets.

Taking More Risks

Since 2000, the typical American family is earning a bit more and spending a lot more—just on the basics. But the financial picture has another dimension. Today's families are taking on more financial risk.

The risk is most prevalent when it comes to a family's health. The number of Americans who get up every morning and head to work, knowing that one moderate accident or one bad diagnosis could turn them upside down financially, has continued to grow.

[22] An estimated 20 percent to 30 percent of college students have debt burdens so large that they are difficult to manage. Sandy Baum and Marie O'Malley, *College on Credit* (Washington, D.C.: Nellie Mae, 2003).



By 2005, an additional 6.8 million Americans had no insurance coverage. In effect, they put everything they own, everything they might have saved, and their future financial stability at risk every day.

Even the families with health insurance have no guarantees that they will not be crushed in the financial fallout of a medical problem. About half of all the families filing for bankruptcy do so in the aftermath of a serious medical problem—and three-quarters of those families had health insurance at the onset of their illness or accident.[23] By 2005, every thirty seconds an America family filed for bankruptcy as they struggled to recover from the financial consequences of an illness or accident.

Another risk will be felt in the future. Between 2000 and 2005, the number of workers covered by an employer-sponsored retirement plan shrank from 56.2 million to 52.5 million.[24] In a world in which half of all Americans have not saved a single dollar for retirement, this translates into far more families living with a far less secure future.

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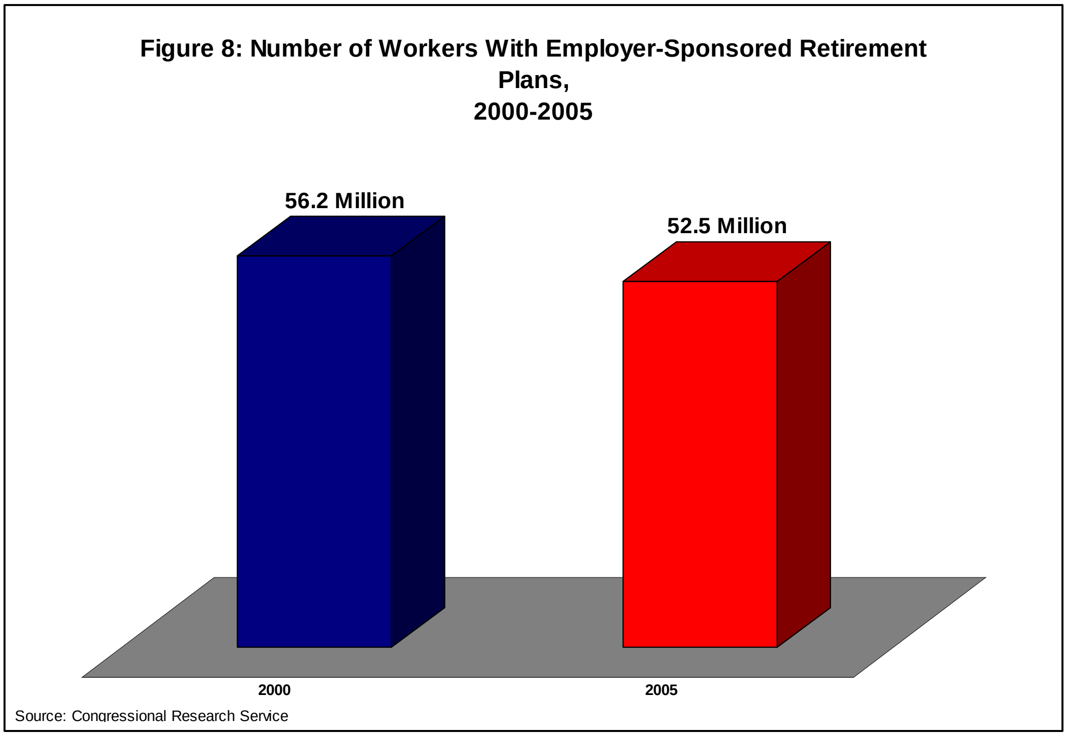
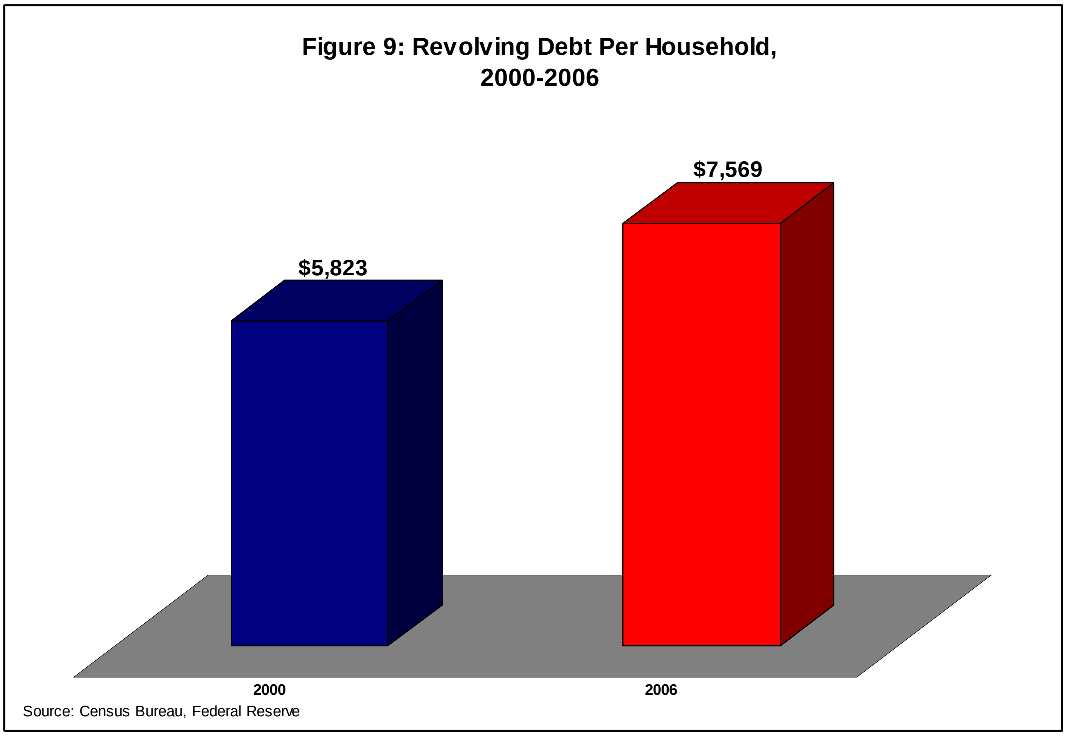
[23] David Himmelstein, Deborah Thorne, Elizabeth Warren and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, HEALTH AFFAIRS (February 2, 2005).

[24] Patrick Purcell, PENSION SPONSORSHIP AND PARTICIPATION: SUMMARY OF RECENT TRENDS 6, p. 6 (Congressional Research Service 2006), available at wmitchell.edu/elderlaw/documents/CRSPension0806.pdf



In order to cope with flat incomes and rising costs, American families have taken on substantially more debt. While some households manage to get by with nothing more than a mortgage, others are caught in a cycle of revolving payments on credit cards and payday loans. In 2000, the average revolving debt per household was a staggering $5,823; by 2005, the average had jumped to $7,569 per household.[25] On average, this would mean that in 2000, revolving debt amounted to 10.2% of household income, but by 2006, it had jumped to 12.1% of income.[26]

[25] Figure calculated using total revolving debt for relevant years from Federal Reserve Statistical Release, *Consumer Credit*, available at http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.html, and number of households for relevant years from U.S. Census Bureau, available at www.census.gov.
[26] *See id.*, with addition of data on mean household income for relevant years from U.S. Census Bureau, available at www.census.gov.



When families shift from holding savings to carrying debt, every other risk they face is magnified. Back in 1973, when the personal savings rate was 11.7% of household income, the family had a cushion if something went wrong. By 2000, that cushion had shrunk to 2.4%, but at least families were able to set something aside. But the slide has intensified. The Federal Reserve reported that family savings has declined so precipitously that for more than a year, savings have been negative. By the second quarter of 2006 the savings rate has dropped to -0.7%.[27]

This means that if a family stumbles—a family without health insurance or retirement, a family trying to pay more to keep the house and more to send the kids to school—the fall is quick and sharp. The savings cushion that once protected the family if anything went wrong has been replaced by a much bigger debt load that will help sink them.

Adding It Up

Compared with 2000, today's worker has $275 more to spend each month. But what has happened to that $275?

The increase in housing expenses ate a $300 chunk out of the family budget. The increase in health insurance was another $378. Gasoline took an additional $152. That is

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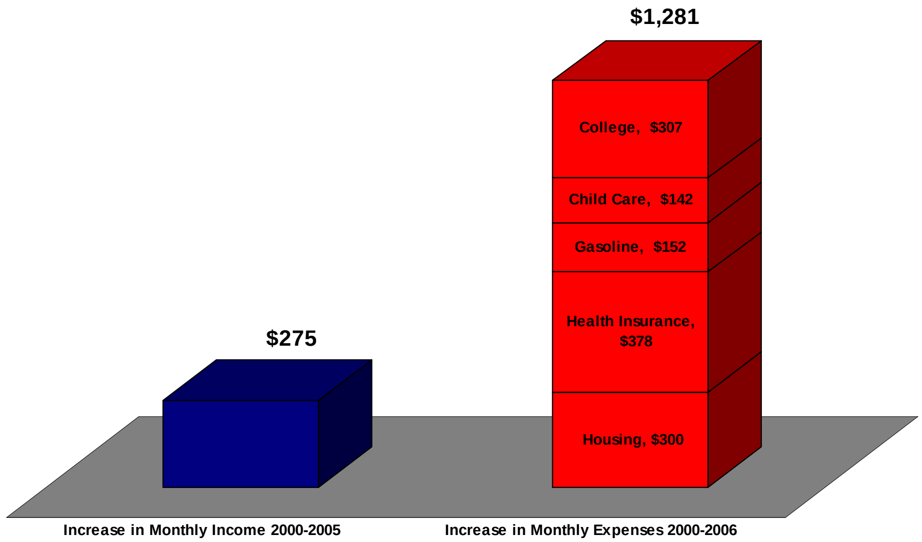
[27] Bureau of Economic Analysis, *Personal Income and Its Disposition* Table 2.1, available at www.beagov/bea/dn/nipaweb/TableView.asp?SelectedTable=58&FirstYear=2004&LastYear=2006&Freq=Qtr.

$830 in new expenses each and every month for just these three items. Before inflation takes its toll in the increased price of a cup of coffee or the cost of a new car, the typical American family has consumed every penny of the increased wages for a fully-employed male and is now $546 deeper in the financial hole than in 2000.

For families with children, the pressure is more intense. If they have one pre-schooler, the change in childcare costs will push the family another $142 in the hole. If they have a son or daughter in college, the increase in costs is another $307 each month out of the family budget—or added to the long-term debt load. And if the family has two pre-schoolers or two children in college, the numbers only get worse.

Figure 10: Monthly Income & Expense Changes, 2000-2006



We wish we could have come here today to say that the middle class American family has turned a financial corner, that it is now regaining its economic footing. We cannot. The numbers are unambiguous. The middle class American family is caught in an economic vise—squeezed by flat earnings on one side and increased expenses on the other.

Middle class American families are fighters. To cope with these forces, families have tried every possible financial strategy. Some are working more hours, so that mothers of small children take full-time jobs out of financial necessity. Others have dealt with rising costs by stripping themselves of health insurance and pensions. Most have given up on saving for college or retirement—or even putting aside a few dollars for the next small emergency. Millions have gone deeply into debt.

The American family is rapidly running out of options. It is time to make changes that don’t require these choices from families, time to give them the chance to regain their financial footing and to put away something for tomorrow.

The hardworking, play-by-the-rules middle class family is under enormous financial pressure. It is time to take some of that pressure off families.